The changing global economic architecture:

How it will affect countries in Europe?

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1. Introduction

After the World War II, world leaders were not ready to let another dictator to create an extreme form of nationalism. To reduce the risk of another war, they joined together with policies and economic conditions that would discourage war between nations. This is how world leaders created the “trade agreement” to combined the economies of independent nations, which increased GDP in exchange for lowering the risk of war. This agreement led few nations into ‘free trade’ agreements and reduced trade tariffs with neighboring nations.

To minimize future conflicts, allied nations led by the United States, formed the United Nations in 1945. The UN is an international organization whose stated aims are to facilitate cooperation in international law, international security, economic development and human rights issues – in the hope that it would intervene in conflicts between nations and thereby avoid wars.

The European Union can be traced to the European Economic Community formed in 1957 by the Treaty of Rome between six European countries. The EU was created first and foremost as an economic union. Creating and maintaining the EU’s single market has been a primary goal – ensuring free movement of people, goods, services and capital. In 1999 the twenty-seven-member state EU introduced the common currency, the euro. With almost 500 million citizens the EU generated an estimated 31% of the world’s GDP in 2007. The euro was created to compete with the dollar, which had become the currency of the world.

In 2000-2006, the global economy continued to grow because of the coupling of the once independent nations of the world in the hope of stabilizing the world markets and improving the economic conditions of emerging nations. But, during the globalization process, major financial institutions around the world lowered their standards for evaluating risk when evaluating loans from other nations that they trusted because of their new free trade agreements. When a loan was sold several times across several nations, the financial institutions no longer had any reference to determining the risk of the loan. All they had was a security institution from another nation rating the risk of the loan. If the rating was wrong, the loan was worthless – and as it turns out, a lot of ratings were wrong. So the risk of bad loans was spread across the financial institutions of the world, creating a ‘house of cards’.

In summer of 2007, The subprime mortgage crisis in the United States led to a severe credit crunch, making borrowing and refinancing difficult for household firms and banks. The credit crunch escalated to full-blown global financial crisis in 2008-2009. The major moments of financial crisis came in lime light on 14th September 2008, when Lehman Brothers (a major U.S. bank with global presence) went bankrupt. The severe failure of a big bank affected the trust in the financial markets and institutions around the world.

The financial crisis swamped not only the advance economies such as the United States, Japan, and the European Union, but also many emerging economies, including Brazil, China, and Russia, although less severely. The world was sliding into the “Great Recession”, the most serious, synchronized economic downturn since the Great Depression. The global financial crisis confirmed the growing independence of the global economy and the need to coordinate economic policy on the global scale. The financial institutions were failed to maintain the financial stability on a Global scale that is why due to the financial crisis one part of global economy caused “global meltdown”.

This paper will argue about the global economic architecture and how it’s changing. Paper will have four main targets -: 1- Explanation of Global economic architecture and what are the trends. 2-What is current European Economy and the strengths? 3- how global economy trends are affecting the European countries? 4-What challenges Europe is facing? 5- How Europe can increase the productivity and improve its economy?

2. Global Economic Architecture

The term “globalization” became a popular buzzword for describing business practices in the last few decades, and it appears as if it will continue to be a key word for describing business management through out the current century. In this section we will review several global trends and development of global economy.

2.1 Development of Global Economy

Currently we are living in a highly ”globalized and integrated world economy”. For example Indian consumer buying regularly used petroleum products imported from Middle East, electronic goods from China, steel from Korea, machinery from the United States, and transport equipment from Germany. Others for example Europe purchase Indian software, food products, jewelry, pharmaceutical drugs, and garments from India. Certainly, continued liberalization of international trade is setting up the internationalize consumption patterns around the world. Not only international consumption but also production of goods and services has become highly globalized. This has happened as a result of multinational corporations’ (MNCs) efforts to source inputs and locate production anywhere in the world where costs are lower and profits are higher. For example – Europe mostly is out sourcing the technology from India, as Indian Engineers are cheaper to higher than European. Financial markets have also become highly integrated due to technology. This development allows invertors to diversified their investment portfolios internationally. Undoubtedly, We are living in a world, where all the major economic functions- consumptions, productions and investments are highly globalized. Advances in computer and telecommunications technology have been playing a major role in the emergence of global financial markets. These technological advances made life easier for investors sitting around the world to communicate and accessing the most recent news.

2.2 Trends in global economic growth

Virtually no countries, developing or high-income, have escaped the impact of the widening crisis, although those countries with stronger fundamentals going into the crisis have been less affected. If we look at the situation of twenty years before the financial crisis which countries were leading. In 1990-2000 – United States dominated the expansion. 2000-2006- China started catching up United States but still U.S. was leading. During this time five largest contributors to global economy output expansion were the U.S. at 20%, China at 9%, Germany at 6%, the United Kingdom at 6% and France at 5%. In 2007 China was leading and in 2008-2009 financial crisis was spreading around the world. 2010 was more of recovery year for China, U.S., Japan, Brazil and India.

2.2.1 Developing Countries

If we look at the developing countries, they have responded very well towards the financial crisis in 2007-08. They have a high importance in improving the global economy. More to the point, developing countries might have to increase the growth from supply-side reforms that increase underlying growth potential.

2.2.2 High Economies Countries

Now, after several years of extreme weakness, high-income economies (United States, Europe, Japan) are also coming back and contributing to the global growth from 2.4% in 2013 to 3.2 % this year. Euro area also made progress by the end of second quarter of 2013 due to high growth in Germany. Not only Western European economies have strengthened but also troubled Southern European (three of the five – Ireland, Portugal and Spain) economies has been stronger and exited the recession. This has been possible due the strong export growth. Recession in other two countries out of five (Italy and Greece) is also easing out. But still European economy remained below pre crisis level.

2.3 Shift in Global Economy

In the recent months, composition of global economic growth has shifted, and the external environment has become more challenging for EU economy than before. Economy growth has been slowed down in some of the key emerging markets, triggered by the anticipation of less expansive monetary policies in the US. In the half of 2013, advanced economies contributed more in the global growth than emerging markets. Overall, the external environment has become somewhat more challenging than projected in the beginning of 2013. Economic activities outside the EU is now expected to grow at a more measured pace than anticipated half a year ago, at 3½% in 2013, accelerating to 4% in 2014 and 4½% in 2015. Reflecting the trade intensity of GDP growth in emerging market economies, world trade growth is revised down to 2¾% in 2013, 5¼% in 2014 and 6% in 2015. At the same time, oil prices have increased above the levels assumed in May 2013, though they are assumed to decrease gradually, and the nominal effective exchange rate of the euro assumed to prevail in 2014 is now 3% higher than last spring (based on the technical assumption of unchanged nominal exchange rates).

3. Current European Economy

The Financial crisis of 2008 in United States also affected the GDP of the majority of European Economies, Which was far problematic than Eurozone debt crisis; which also caused the collapse of economies in the south, particularly Italy. Due to ongoing political crisis, recently affected Portugal, Spain, Ireland and Greece were also hit hard. Meanwhile increased bailout of the International Monetary Fund and European Central Bank alleviates the situation in the debt-stricken nations.

4. Path from crisis to recovery

In the second quarter of 2013, GDP has started to expand in the EU and in the euro area by 0.3% q-o-q, signaling the end of recession. Economic indicators for the EU have provided mostly positive signals since April, and suggest a continued but modest expansion in the second half of the year. The recovery remains subdued and fragile as the impediments stemming from the financial and economic crisis continue weighing on economic activity, while the global growth outlook has weakened. Based on the assumption that continued policy effort will sustain improvements in business and consumer confidence, financial conditions and Member States' economic adjustment capacity, economic activity in the EU is expected to continue recovering in the coming quarters. But major drags acting on domestic demand will fade only gradually.

5. Europe has many strengths on which to build

Europe’s economies have had different positions on the starting grid for this journey, and their progress thus far has been uneven. Europe has a severe ‘debt hangover’ from the global meltdown, the regions has considerable strengths in which it can build a robust ad sustainable recovery. These strengths are not that visible -:

5.1 Economic integration

Efforts to strengthen the single market within the European Union need to continue, Europe can already claim to have become the largest economy in the world. In 2009, the European market boasted approximately 101 million households earning more than $35,000 a year, adjusted for PPP, compared with 88 million such house holds in the United States.

5.2 Vibrant and successful cities

Cities are the electric generators of the world growth, accounting today for more than 80% of global economic activity. Western Europe boasts 109 of the to 600 cities in the world ranked by their GDP and Eastern Europe another 44. European companies that meet the needs of cities in construction, infrastructure, business services, and financial services, for instance will be well placed to benefit from the huge wave of urbanization under way in the developing world. Over the next 15 years, By 2025, nine of the world’s top 25 cities ranked by GDP will be located in ASIA, up from two in 2007 and four cities in Western Europe. Even though, European cities will remain vibrant, important centers of global economic activity with fine infrastructure and advanced transportation links. London, Paris, the German conurbation of Rhein-Ruhr, and the Dutch conurbation of Randstad will all be in the top 25 in 2025.

5.3 Leading Corporations

The continent is home to many world-leading corporations. The single market is power full springboard for European Business. Companies in Europe are growing more rapidly than companies in USA. European companies are in strong position to take advantage of major trends in global economy, including the rapid growth of developing economies and waves of innovation in green (for example German companies are among the leading global producers of solar cells) and other cutting edge technologies (for example five of the nine leading firms in biotech are based in Europe). It's always been very interesting factor for business world that Europe traditionally been strong at developing human capital. Also UK's Oxford and Cambridge are the top profilers universities in the world. Europe owns the 20% top ranked universities globally.

5.4 Reforming the labour market and productivity

Some European countries have made significant progress in reforming the labour markets and increasing the productivity in particular sectors. Germany has been a strong reformer of labour market by creating the constructive employer union negotiations that have helped to reduce unemployment, hold down the labour cost, and improve the economy's over all competiveness. Europe has definite progress on the smart regulation of product markets. Now Government narrowed down the gap between EU-15 average and other major OECD countries, due to less government control and relaxed barriers to competition in the utility. This approach has boosted the productivity of few sectors including road transport in France and Germany, retail in Sweden, and construction in UK. The Swedish experience is particularly instructive for the rest of the Europe.

5.6 Quality of Life

While talking about Europe's strengths, how can someone forget about the fact that Europe is top ranked for the quality of life? Europe scores well on non-growth indicators that measures sustainability and quality of life dimensions such as health, education, social inclusion, security, and the environment. On an average, a person born Europe can live three more years of healthy life than a U.S. citizen. From 1970 to 2013, life expectancy increased by more in France and Germany than it did in United States. European Society has less focus on significantly lower income then we see in the United States.

6. Challenges need to be addressed

Despite the many strengths but Europe faces profound long-term challenges that, if unaddressed, could compromise growth. Europe needs to face up to four challenges if it is to secure robust and sustainable long-term growth.

6.1 Global Competition

European countries might be facing competitive challenges from emerging economies and regions in Latin America and Asia. By 2030, BRICS countries (Brazil, Russia, India, China, South Africa) alone are expected to generate 38 % of the world economy. As Japan, South Korea, and Taiwan did before them, these emerging world economic giants are likely to move their production capacity from labour to capital to knowledge to incentive and source of competitiveness evolve in the parallel. The speed and scale of change in these large developing economies is unprecedented, this is why advanced economies are being forced to adjust. Companies in advanced economies are moving up the value chain, offshoring lower – value- added tasks such as assembly and migrating employment to higher skills levels. While the EU-28 current account is fairly balanced over all.

6.2 Low productivity growth

Europe had been competing with USA on productivity. From 1970, labour productivity for the EU-15 was 35 per cent lower than US levels. By 1995, the gap was only 10 per cent, and Europe had over taken the United States. But since the mid-1990, that gap started widening again. Reversing this trend in labour productivity is essential. Europe will need to accelerate productivity growth by around 30 per cent over the historic level just to maintain the past GDP growth levels. Boosting productivity growth is likely to become more challenging. Countries can close a large gap to leader relatively quickly by adoption of existing technologies, best business practices. Since the beginning of the process of industrialization, periods of faster productivity growth have required large-scale technological innovation; the world's leading nations have seen long-term average productivity growth of only 1.4 per cent per annum. If we look at the Europe's stagnant growth, it could be trapped in low GDP growth at or around 1.5 per cent unless it can capture some new driver of accelerated productivity growth.

6.3 Aging putting pressure on the labour force and impacting on public budgets

Population in Europe, is aging rapidly due to the combination of increasing long life and decreasing fertility, most marked in Germany, Italy, and Spain. For example -: Median age in Italy, was 28.6 in 1950 and 43.3 in 2010, and is estimated to climb up to 50.1 by 2030. Aging will put pressure on growth, dependency ratios and public budget. The expected trend in immigration, the EU-15 labour force is expected to decline by 0.1 % a year over the next 20 years. Pension systems rely on low dependency ratio for the working generation to provide goods and services for the older generation. In the EU-15, the old age dependency rate is expected to almost double from .27 in 2010 to .52 in 2060. The deterioration should be partly balanced by a lower youth dependency ratio and higher participation rate participation rates particularly among seniors. If we look at the two ratios together, by 2035, EU-15 will need to spend 3.4% of GDP more than it did in 2007 directly because of aging. Of this, 1.8 per cent is due to the cost of pensions, 1.0 percent due to increase demand for health care, and a further 0.6 per cent to long-term-care provision. The impact of a changing age mix has been positive or negative in the past years but it will become significantly negative in the next decades.

6.4 Dependency on energy imports and increasing prices

In the Europe as else where, energy is a major challenge. Over the past century, resources prices have fallen by 1 per cent a year in real terms. However, resources prices have doubled, reflecting supply constraints in oil and rapid demand growth from emerging economies for material. In 2008, European countries imported 1,010 million tones of oil equivalents, net of exports, equal to 53.8 per cent of its energy consumption. On the demand side, global energy demand is expected to rise by 32 per cent by 2030. Energy infrastructure requires substantial investment. Another challenge of the energy imports is the fact that European countries are the third largest producer of carbon dioxide after China and United States. The European commission is committed to reducing energy consumption by 20 per cent compared with 1990 level. The Baltic States and Germany have actually achieved their 2020 target, and the UK is close to it. But others, including, Cyprus, Malta, and Spain, have seen their emission increase. Europe can achieve its target of a 20 per cent cut in emissions and projected annual growth in demand down to zero through action to boost energy productivity, the level of benefits we achieved from energy we consume. Attitudes towards nuclear power vary widely across Europe, and the future role of nuclear energy remains unclear given the disaster in Japan. If Europe turns against nuclear power, that will further complicate its strategy for energy security and the reduction of carbon emission.

7. Conclusions

The interaction of these four forces creates the potential for a very uncertain and volatile future for Europe. There is much that European business, with the enabling hands of policy makers, can do to meet the challenges ahead. I would like to share four priorities that Europe needs to address in order to secure its long-term growth and renewal.

7.1 Win in tradables and manage the rebalancing of the world Economy

To date, Europe had held its own in global exports. However, the region faces ever-increasing competition from emerging markets whose companies are rapidly moving up the value chain to compete more directly with Europe's advanced industrial leaders. Europe needs to continue to maintain a healthy manufacturing sector, but it will also need to win in growing export markets for services and intangible goods. In fact, I believe that the distinction between manufacturing and services is increasingly irrelevant in an advanced economy. What matters is that a country or a region such as Europe maintains competitiveness in all tradable sectors of the economy.

7.2 Support Growth through R&D and Innovation

Productivity tends to grow slowly except in periods that see waves of innovation. Europe's policy makers talk a deal about the importance of the innovation and in particular of supporting R&D, but the region's record is somewhat weak. The EU still allocates a large share 32 per cent of its funds to preserving slow-growing, low-productivity industries such as agriculture and coal mining, with only 8 per sent going to

R&D. Indeed, Europe's R&D spending is below the OECD average. Government can also help through providing incentives for R&D, improving collaboration between academe and industry, supporting venture capital funding, encouraging skilled immigration, and establishing programs to encourage entrepreneurship. It is also essential that Europe remains an attractive location for multinational corporations, which are major contributors to productivity growth and innovation in advanced economies. European leaders need to focus on increasing the productivity by investing in innovation and human capital.

7.3 Structural development and increase productivity in service sector

Europe needs to exploit major opportunities to make headway on productivity growth in service sectors. While the EU-15's manufacturing and utilities have performed in line with the United States and contributed an important 60 per cent of overall productivity growth, the story on services has been far less impressive. Growth in services has been particularly slow in Continental and Southern Europe. By Contrast, in the more liberalized economies of the Nordic region, and the United Kingdom and Ireland, there had been strong growth in the service sectors and not just financial services that has accounted for the more rapid increase in value added of these economies. There is substantial to drive higher productivity growth in services through smart regulation that removes hurdles to competition and growth.

7.4 Consolidate Europe's Fiscal Position

The Eurozone debt crisis is likely to be the dominant focus of economic policy of several years to come, not only within Eurozone but, given the interconnectedness of all Europe's economies, across the entire continent. The stakes are huge. There are some priorities for actions that will make the crisis more manageable and lessen its impact on the broader economy. 1- Europe needs to improve the resilience of the baking system though rigorous stress tests and, where necessary, further capital raising. The European banking system is now far better capitalized than it was pre-crisis and is much more resilient. 2- Europe should pursue pro-growth structural reforms in order to improve competitiveness. Over recent years, the more radical structural reforms have been undertaken by the countries that are now in the best fiscal position e.g the Nordics, Germany. 3- Europe should prepare for the future by taking lessons from financial crisis, it has reminded that private debt can quickly turn into public debt and severe crises.

The immediate challenged of the debt crisis and continued headwinds from public and private sector deleveraging undoubtedly present major challenges to all Europe's economies over the next few years. However, Europe has many of the competitive advantages needed to succeed in the highly global economy over the next two to three decades with more than 500 million citizens, high educational standards, hundreds of the world's leading corporations, many of the world's greatest universities, a rich cultural heritage, and a high quality of life.

The barriers to Europe achieving its full potential are largely within Europe's own control bringing order to public finances, continuing to pursue structural reform, and creating the conditions within which the private sector can compete and innovate. Provided Europe addresses these challenges, there is no reason why it cannot fully return to a path to sustained economic growth and renewal.

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